

Summer 1990

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Paul A. Dominick

Leon C. Harmon

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### Recommended Citation

Dominick, Paul A. and Harmon, Leon C. (1990) "Lender Limbo: The Perils of Environmental Lender Liability," *South Carolina Law Review*: Vol. 41 : Iss. 4 , Article 8.

Available at: <https://scholarcommons.sc.edu/sclr/vol41/iss4/8>

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# LENDER LIMBO: THE PERILS OF ENVIRONMENTAL LENDER LIABILITY

PAUL A. DOMINICK\*

LEON C. HARMON\*\*

## I. INTRODUCTION

The 1980s was a decade of rapidly expanding environmental legislation and regulation at both the federal and state levels. These laws and regulations substantially increased the risks associated with real estate loan transactions. The obvious goal of a lender is to make good, collectible loans. In the past, appreciation of real estate could almost be assumed. Consequently, a mortgage fully securing a debt usually allowed a foreclosing lender to cover at least a substantial portion of the principal loan amount. Now, when a hazardous waste problem exists on the property, a security interest in real estate can be rendered worthless and even become a liability beyond the amount of the loan. Other loan transactions also can become problems when the financial condition of the borrower is jeopardized by environmental enforcement actions or citizen suits.

As with any rapidly developing area of law, many unanswered questions exist which create potential pitfalls. A prudent lender, however, can position itself to avoid these potential pitfalls, as well as the known trouble areas, presented by the environmental laws.

Two federal statutes constitute the major sources of liability for the cleanup of contaminated land: the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or Superfund)<sup>1</sup> and the Resource Conservation and Recovery Act (RCRA).<sup>2</sup> The South Carolina General Assembly also has enacted three statutes which may impose liability: the South Carolina Hazardous Waste Management

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\* Partner, Nexsen Pruet Jacobs & Pollard, Columbia, South Carolina, B.A., University of South Carolina, 1976; J.D., Washington and Lee University School of Law, 1979. Mr. Dominick is a litigation attorney with experience in environmental cases.

\*\* Special Counsel, Nexsen Pruet Jacobs & Pollard, Columbia, South Carolina, B.S., Clemson University, 1971 (Chemical Engineering); J.D., Emory University School of Law, 1982. Prior to entering law school, Mr. Harmon had twelve years of experience as a professional engineer in the areas of environmental, chemical and energy engineering. Mr. Harmon is an environmental attorney with experience in regulatory and litigation matters.

1. 42 U.S.C. §§ 9601-9675 (1982 & Supp. V 1987).

2. *Id.* §§ 6901-6992.

Act;<sup>3</sup> the South Carolina Pollution Control Act;<sup>4</sup> and the South Carolina Underground Petroleum Environmental Response Bank Act.<sup>5</sup> In addition, various other federal statutes<sup>6</sup> and common law theories<sup>7</sup> can potentially have an impact on real estate lending transactions.

## II. COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION AND LIABILITY ACT (CERCLA)

CERCLA is currently the primary statutory vehicle for imposing lender liability for hazardous waste problems. Congress passed this Act in response to several waste site discoveries in 1978, the most notorious of which occurred at the Love Canal site in the state of New York.<sup>8</sup> The Love Canal incident involved a school built atop an abandoned canal into which highly toxic chemicals had been dumped for at least ten years. The chemicals infiltrated homes as well as the school, and by 1978 the seriousness of health problems discovered in the area<sup>9</sup> led President Carter to declare a state of emergency and the state of New York to evacuate the area.<sup>10</sup> Public concern over Love Canal and similar hazardous waste emergencies resulted in the passage of CERCLA.<sup>11</sup>

The strength of CERCLA is in the funding available for the Environmental Protection Agency (EPA) to pay for cleanup costs when a responsible party cannot be found or cannot be required to clean up

3. S.C. CODE ANN. §§ 44-56-10 to -510 (Law. Co-op. 1976 & Supp. 1989).

4. *Id.* §§ 48-1-10 to -350.

5. *Id.* §§ 44-2-10 to -140 (Law. Co-op. Supp. 1989).

6. See Safe Drinking Water Act, 42 U.S.C. §§ 300f to 300j-26 (1982 & Supp. V 1987); Occupational Safety and Health Act (OSHA), 29 U.S.C. §§ 651-678 (1982 & Supp. V 1987); see also 29 C.F.R. § 1910.1001 (1989) (OSHA's general asbestos regulations).

7. See *Neal v. Darby*, 282 S.C. 277, 318 S.E.2d 18 (Ct. App. 1984) (solvent reclamation company's landfill a public nuisance); *Davenport v. Woodside Cotton Mills Co.*, 225 S.C. 52, 80 S.E.2d 740 (1954) (unauthorized dumping of industrial waste a trespass).

8. See Lipper, *Mortgage Acceleration: The Lender's Prescription for Avoiding the Comprehensive Environmental Response Cleanup and Liability Act (CERCLA)*, 35 J. URB. & CONTEMP. L. 129, 131 (1989).

9. See *id.* at 130 n.9.

10. *Id.* at 130 n.8 and accompanying text. Other incidents in 1978 occurred in Toone, Tennessee, where residents found their water supply contaminated by a chemical facility that had closed six years earlier, despite the assurances of government officials that the water was safe to drink; near Charles City, Iowa, where EPA officials found the Cedar River contaminated with poisons from a nearby dumpsite; and near Louisville, Kentucky, where 6,000 of 17,000 drums disposed of by chemical manufacturers oozed toxic chemicals into the ground. *Id.*

11. Enacted on December 11, 1980, CERCLA was a hastily drafted compromise at the end of a lame duck session. See Grad, *A Legislative History of The Comprehensive Environmental Response, Compensation and Liability ("Superfund") Act of 1980*, 8 J. ENVTL. L. 1 (1982).

the site. Originally, Congress authorized 2.2 billion dollars to fund CERCLA from 1981 through 1985.<sup>12</sup> In 1986 this funding was boosted to 8.5 billion dollars when Congress enacted the Superfund Amendments and Reauthorization Act (SARA).<sup>13</sup> Armed with this funding, the EPA can proceed to clean up a hazardous waste site<sup>14</sup> and then take legal action against potentially responsible parties (PRP's) to recover the funds actually expended on the cleanup.<sup>15</sup> The EPA also may request a federal district court to intervene by granting injunctive relief against responsible parties when there is evidence of imminent and substantial danger to the public health or welfare or to the environment.<sup>16</sup>

Any state agency which has entered into a cooperative agreement to carry out investigative and response duties may exercise EPA authority.<sup>17</sup> In South Carolina, the Department of Health and Environmental Control (DHEC) has such a cooperative agreement and is authorized to implement and enforce CERCLA.<sup>18</sup>

An enforcing agency may respond to contamination by investigation, removal and any other remedial or response action consistent with the National Contingency Plan.<sup>19</sup> Any private party incurring cleanup costs may also maintain an action against a legally responsible party to recover those costs.<sup>20</sup>

There are four categories of persons or institutions who are potentially liable for cleanup costs under CERCLA: (1) current owners or operators of facilities with hazardous waste disposal sites; (2) any person who owned or operated facilities with hazardous waste sites at the time of disposal; (3) any person who contracts or arranges for disposal of hazardous waste at a facility owned by another person; and (4) any person who accepts hazardous waste for transport to disposal sites selected by that person and from which there is a release of hazardous waste.<sup>21</sup>

The focus for lender liability cleanup costs is determining whether the lender can be categorized as an "owner or operator."<sup>22</sup> As with the

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12. 42 U.S.C. § 9631(b)(2) (1980) (repealed 1986).

13. Superfund Amendments and Reauthorization Act of 1986, Pub. L. No. 99-499, 100 Stat. 1613 (1986); see 42 U.S.C. § 9611(a) (Supp. V 1987).

14. 42 U.S.C. § 9604(a)(1) (Supp. V 1987).

15. See *id.* § 9607(a)(4).

16. *Id.* § 9606(a) (Supp. V 1987).

17. *Id.* § 9604(c)(3) (1982 & Supp. V 1987).

18. S.C. CODE ANN. § 44-56-200 (Law. Co-op. 1976).

19. 42 U.S.C. § 9604(a)(1) (Supp. V 1987).

20. *Id.* § 9607(a)(4)(b) (Supp. V 1987); see *Walls v. Waste Resources Corp.*, 761 F.2d 311, 318 (6th Cir. 1985).

21. 42 U.S.C. § 9607(a) (Supp. V 1987).

22. If the lender, or any other defendant, is found to be within one of the categories

legislative history, the case law in this area is sparse. Because so few reported cases exist dealing with these issues, the impact of individual cases often tends to be exaggerated. Most of the reported cases are federal district court decisions on motions either for summary judgment or for dismissal. The review standards applied by courts in deciding such motions are different than those used in deciding an appeal after a final judgment.<sup>23</sup> Nevertheless, prudent lenders should view these cases as warnings and as bases for structuring sound lending practices to avoid environmental liability.

In *United States v. Mirabile*<sup>24</sup> the Pennsylvania District Court stated that "participation in operational, production or waste disposal activities" would result in liability under CERCLA.<sup>25</sup> The *Mirabile* case was before the court on motions for summary judgment by the three defendant financial institutions: Mellon Bank, Inc. (Mellon); The Small Business Administration (SBA); and American Bank and Trust (ABT).<sup>26</sup> The focus of the court's inquiry was whether the activities of the financial institutions had risen to the level of an "owner or opera-

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of potentially liable persons, then the lender will be strictly liable for response costs unless it can avail itself of one of the specific defenses enumerated under CERCLA. See *United States v. South Carolina Recycling & Disposal, Inc.*, 653 F. Supp. 984, 991 (D.S.C. 1984), *aff'd in part, vacated in part on other grounds sub nom. United States v. Monsanto Co.*, 858 F.2d 160 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 3156 (1989). When the harm is indivisible, defendants have joint and several liability for response costs. *Id.* at 994. The liable defendants may seek contribution from each other. 42 U.S.C. § 9613(f)(1) (Supp. V 1987). A settling party, however, shall not be liable for claims for contribution arising from matters addressed in the settlement. *Id.* § 9613(f)(2).

23. In reviewing a motion for summary judgment,

the nonmoving party is in a favorable posture, being entitled "to have the credibility of his evidence as forecast assumed, his version of all that is in dispute accepted, all internal conflicts in it resolved favorably to him, the most favorable of possible alternative inferences from it drawn on his behalf; and finally, to be given the benefit of all favorable legal theories invoked by the evidence as considered."

*Ross v. Communications Satellite Corp.*, 759 F.2d 355, 364 (4th Cir. 1985) (quoting *Charbonnages de France v. Smith*, 597 F.2d 406, 414 (4th Cir. 1979); see *Pulliam Inv. Co. v. Cameo Properties*, 810 F.2d 1282, 1286 (4th Cir. 1987)).

In ruling on a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), all doubts must be resolved in favor of the nonmoving party and a dismissal should not be granted unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which entitle him to relief." *Chiles v. Crooks*, 708 F. Supp. 127, 129 (D.S.C. 1989) (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)).

24. 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,994 (E.D. Pa. Sept. 4, 1985).

25. *Id.* at 20,995.

26. The three financial institutions were included in this suit pursuant to the third-party claims of the Mirabiles. ABT obtained the property at a foreclosure sale, but assigned its successful bid to Anna and Thomas Mirabile. *id.* at 20,993. At the time the suit was instituted by the government, the Mirabiles were the owners of the property. *Id.*

tor" within the meaning of the statute.<sup>27</sup> The court determined that the SBA participated in financial decisions only, and thus granted the SBA summary judgment.<sup>28</sup> ABT took title to the property at the foreclosure sale, but the court found that ABT met the security interest exemption.<sup>29</sup> The court denied Mellon's motion for summary judgment. The court decided that certain deposition testimony indicated Mellon's involvement in day-to-day operations was sufficient to deny summary judgment.<sup>30</sup> Nevertheless, the court stated:

The reed upon which the Mirabiles seek to impose liability on Mellon is slender indeed; however, bearing in mind that all doubts are to be resolved in favor of that party opposing a motion for summary judgment, I conclude that, taken as a whole, the deposition testimony outlined above presents a genuine issue of fact as to whether Mellon Bank, through its predecessor Girard Bank, engaged in the sort of participation in management which would bring a secured creditor within the scope of CERCLA liability. In particular, it would be helpful to have a clearer picture of McWilliams' participation in the manufacturing processes and of the extent to which Garfinkel acted at the direction of Girard.<sup>31</sup>

Thus, the issue of ultimate CERCLA liability was far from resolved. From a practical standpoint, however, Mellon Bank faced substantial legal fees to defend the action and a realistic risk of a damaging ad-

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27. *Id.* at 20,995. Individuals also may be held to be "owners or operators" under CERCLA. *See, e.g., New York v. Shore Realty Corp.*, 759 F.2d 1032, 1052 (2d Cir. 1985) (stockholder who manages corporation individually liable); *United States v. Carolawn Co.*, 14 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,699, 20,700 (D.S.C. June 15, 1984).

28. *Mirabile*, 15 Env'tl. L. Rep. at 20,997. The SBA had financed the operations of Turco Coatings, Inc., the company that created the hazardous condition prior to foreclosure. *Id.* at 20,995. Although the SBA had the right to participate in management, the court found no evidence that it did so. *Id.* at 20,996. Furthermore, the SBA did not foreclose on the site. *Id.* at 20,997.

29. *Id.* at 20,996. The court stated that the security interest exemption excludes from the definition of "owners and operators" anyone who "without participating in management of a . . . facility, holds indicia of ownership primarily to protect his security interest in the . . . facility." 42 U.S.C. § 9601 (2)(A)(iii) (Supp. V 1987). This part of the *Mirabile* decision has been criticized as incorrect. Some commentators have argued for the imposition of a bright-line test which would establish "ownership" at the passage of title. *See, e.g., Lipper, supra* note 8, at 147-48.

30. *Mirabile*, 15 Env'tl. L. Rep. at 20,997, as with many other decisions in this area, the procedural context of the ruling weakens any precedential value of the decision.

31. *Id.* McWilliams was the Mellon Bank loan officer who had post-bankruptcy oversight of the company. *Id.* Girard Bank was Mellon Bank's predecessor-in-interest. *Id.* at 20,996. Deposition testimony indicated that Girard insisted that Turco accept the day-to-day supervision of Alfred Garfinkel in order to continue receiving operating funds from Girard. *Id.* at 20,997.

verse decision.<sup>32</sup>

When a lender would be considered an "owner" under CERCLA was a primary focus of *United States v. Maryland Bank & Trust Co.*<sup>33</sup> Maryland Bank & Trust (MBT) commenced a foreclosure action on a hazardous waste site in 1981 and purchased the property for \$381,500 at a foreclosure sale on May 15, 1982.<sup>34</sup> After MBT refused to clean up the site, the EPA did so and sued MBT under CERCLA for recovery of over \$500,000 in cleanup costs.<sup>35</sup>

As in *Mirabile*,<sup>36</sup> the case came before the court for resolution of summary judgment motions.<sup>37</sup> MBT contended it was not an "owner and operator" under CERCLA.<sup>38</sup> The statutory dispute revolved around MBT's contention that it had to be both an owner and operator for CERCLA liability to attach.<sup>39</sup> The court, noting inadequate Congressional draftsmanship,<sup>40</sup> stated that current ownership facility is

32. The *Mirabile* case ultimately was resolved when the parties settled on the second day of trial, October 2, 1985. See 1 Toxics L. Rep. (BNA) 710 (November 26, 1986).

33. 632 F. Supp. 573 (D. Md. 1986).

34. *Id.* at 575.

35. *Id.* at 575-76.

36. *United States v. Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,994 (E.D. Pa. Sept. 4, 1985).

37. *Maryland Bank & Trust*, 632 F. Supp. at 576.

38. *Id.* at 577. CERCLA Section 107(a) provides in pertinent part:

Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section—

(1) The owner and operator of a vessel (otherwise subject to the jurisdiction of the United States) or a facility, . . .

. . . .

(4) . . . shall be liable for—

(A) all costs of removal or remedial action incurred by the United States Government or a State not inconsistent with the national contingency plan . . . .

42 U.S.C. § 9607(a) (Supp. V 1987).

The definition of "owner or operator" is set forth in CERCLA Section 101(2)(A) in pertinent part as follows:

"[o]wner or operator" means . . . (iii) in the case of an abandoned facility, . . . any person who owned, operated or otherwise controlled activities at such facility immediately beforehand. Such term does not include a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility

. . . .

42 U.S.C. § 9601(20)(A)(iii) (1982 & Supp. V 1988).

39. See *Maryland Bank & Trust*, 632 F. Supp. at 577.

40. *Id.* at 578. The court commented:

The structure of Section 107(a), like so much of this hastily patched together compromise Act, is not a model of statutory clarity. . . . Misuse of the definite article is hardly surprising in a hastily conceived compromise statute such as CERCLA, since members of Congress might well have had no time to dot all the i's or cross all the t's.

sufficient to bring a party within the coverage of CERCLA.<sup>41</sup>

MBT also argued it fell within the security interest exemption which excludes from liability those who do not participate in management, but only hold "indicia of ownership primarily to protect [their] security interest in the . . . facility."<sup>42</sup> The court stated that when a former mortgagee holds title through purchase at a foreclosure sale, it is an "owner" and is subject to CERCLA liability.<sup>43</sup> The court noted that MBT held title to the site for nearly four years, and for one year before the cleanup by the EPA.<sup>44</sup> The court did not consider whether a mortgagee purchasing consider whether a mortgagee purchasing at a foreclosure sale and promptly reselling the property would meet the security interest exemption.<sup>45</sup> It indicated agreement with the *Mirabile* decision, however, in which the purchasing mortgagee resold the site after only four months and was found exempt from liability.<sup>46</sup>

Lenders should not assume that a foreclosure purchase and subsequent sale of the property within four months will insulate the lender from CERCLA liability. Even though legislation has been introduced in Congress to limit lender liability in some cases,<sup>47</sup> there is a risk of CERCLA liability once title to contaminated property is passed. Consistent with this, courts place the burden on lending institutions to avoid the pitfalls of making loans secured by environmentally suspect properties. For example, the court in *Maryland Bank & Trust* stated:

Mortgagees, however, already have the means to protect themselves, by making prudent loans. Financial institutions are in a position to investigate and discover potential problems in their secured properties. For many lending institutions, such research is routine. CERCLA will not absolve them from responsibility for their mistakes of judgment.<sup>48</sup>

This view of the role of lending institutions makes an environmental

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*Id.*

41. *Id.* at 577.

42. *Id.* at 578 (quoting 42 U.S.C. § 9601(20)(A)(iii) (Supp. V 1987)).

43. *Id.* at 579.

44. *Id.*

45. *Id.* at 579 n.5.

46. *Id.* at 580; see *United States v. Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,992 (E.D. Pa. Sept. 4, 1985).

47. In April of 1989, Congressman John J. LaFalce (D-NY) introduced a bill in the House of Representatives designed to limit CERCLA liability of commercial lending institutions acquiring facilities through foreclosure or similar means. See H.R. 2085, 101st Cong., 1st Sess., 135 CONG. REC. H1364 (daily ed. April 25, 1989).

48. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 580 (D. Md. 1986) (footnotes omitted).



audit report a necessary part of most real estate loan packages.<sup>49</sup>

An environmental audit report also may assist in establishing the "third party defense"<sup>50</sup> and the "innocent landowner" defense.<sup>51</sup> Essentially, the third party defense can be asserted when the contamination and damages are caused solely by a third party unconnected with the defendant, and the defendant exercised due care with respect to the contaminant while taking precautions against any foreseeable causative acts or omissions of the third party.<sup>52</sup> In *Maryland Bank & Trust* the government's motion for summary judgment asserted that MBT could not meet its burden of proof on the third party defense.<sup>53</sup> The court agreed and found that material factual issues existed concerning the contractual and business relations between MBT and the prior owner and the reasonableness of MBT's conduct.<sup>54</sup> Part of the factual dispute was whether MBT knew the property was contaminated.<sup>55</sup> An

49. See, King, *Lenders' Liability For Cleanup Costs*, 18 ENVTL. L. 241, 284-86 (1988); see also *infra* notes 121-22 and accompanying text (guidelines issued by Federal Bank System for establishing an environmental risk policy includes a requirement of an environmental risk report).

50. CERCLA section 107(b) establishes the "third party defense" to CERCLA liability. The section provides in pertinent part:

There shall be no liability . . . for a person otherwise liable who can establish by a preponderance of the evidence that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by . . . an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant . . . if the defendant establishes by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions . . . .

42 U.S.C. § 9607(b)(3) (1982 & Supp. V 1987).

51. The "innocent landowner" defense is set forth in the definition of "contractual relationship" under SARA. If a lender "did not know and had no reason to know" of contamination when the facility was acquired, then the defense may be available. 42 U.S.C. § 9601(35)(A)(i) (Supp. V 1987). The defense is difficult to assert successfully because at the time of acquisition, defendant must have "all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice . . . ." *Id.* § 9601(35)(B). In other words, the lender must conduct an appropriate environmental audit prior to making a loan to be secured by real property.

52. See *supra* note 50.

53. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 581 (D. Md. 1986).

54. *Id.* at 581-82. Ultimately, the case was settled the day before the scheduled trial. See King, *supra* note 49, at 273 n.143 (1988).

55. It is interesting to note that MBT knew at some point that the borrower operated a trash and garbage business on the site. *Maryland Bank & Trust*, 632 F. Supp. at

environmental audit report would be evidence of the status of the site at the time of the loan.

A case that arose in Texas, *Tanglewood East Homeowners v. Charles-Thomas, Inc.*,<sup>55</sup> provides little guidance at this time, but could result in additional opinions as the case progresses. The plaintiffs are a group of subdivision property owners seeking damages, response and cleanup costs, and injunctive relief under both CERCLA and RCRA.<sup>57</sup> First Federal Savings & Loan Association of Conroe (First Federal), a lending institution, also was named as a defendant.<sup>58</sup> First Federal, along with defendant residential developers, construction companies, and real estate agents and agencies, allegedly participated in the development of the plaintiffs' subdivision.<sup>59</sup> The subdivision was the former location of the United Creosoting Company and was contaminated with creosote poles which were allegedly buried by defendants when residential development commenced.<sup>60</sup>

Defendants made a joint motion to dismiss the case under Federal Rules of Civil Procedure 12(b)(1)<sup>61</sup> for lack of subject matter jurisdiction, and 12(b)(6)<sup>62</sup> for failure to state a claim upon which relief could be granted.<sup>63</sup> Not surprisingly, the motions were denied by the district court and the rulings were affirmed by the Fifth Circuit on interlocutory appeal.<sup>64</sup> The sole appellant was First Federal, which, for reasons not stated in the record, made its contentions on behalf of all defendants.<sup>65</sup> For this reason, the Fifth Circuit Court of Appeals did not address the defenses that may be available to a lending institution.<sup>66</sup>

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575. Also, the loans were made to the borrower for his two businesses—Greater St. Mary's Disposal, Inc. and Waldorf Sanitation of St. Mary's, Inc. *Id.* Other than a loan secured by a property called "The Hazardous Waste Dump," it is difficult to imagine a lender having more reason to suspect a loan would lead to environmental litigation than did the lender in *Maryland Bank & Trust*.

56. *Id.* at 1568.

57. *Tanglewood*, 849 F.2d at 1571.

58. *Id.*

59. *Id.*

60. *Id.* The cleanup was expected to cost millions of dollars and require the demolition of six houses and construction of bunkers to contain the hazardous materials. *Id.*

61. FED. R. CIV. P. 12(b)(1).

62. FED. R. CIV. P. 12(b)(6).

63. *Tanglewood*, 849 F.2d at 1571-72.

64. *Id.* at 1576. Since the case was before the Fifth Circuit on a motion to dismiss, the court accepted all the allegations of the complaint as true. *Id.* at 1571-72. As stated by the court, "Such a motion will be granted only if 'it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.'" *Id.* at 1572 (quoting *Conley v. Gibson*, 355 U.S. 41 (1957)).

65. *Id.*

66. First Federal was in essence alleged to be a joint developer. Since the court of appeals took the complaint's allegations to be true in reviewing the district court's rul-

The *Tanglewood* court stated that the defendants could qualify as present owners,<sup>67</sup> past owners,<sup>68</sup> and post arrangers and transporters,<sup>69</sup> and thus be subject to CERCLA liability.<sup>70</sup> The importance of the ruling is its consistency with the decisions that support the broad scope of CERCLA liability. Thus, another warning is sounded for the benefit of financial institutions and others exposed to CERCLA liability.

In *United States v. Fleet Factors Corp.*<sup>71</sup> a chief subject of inquiry involved determining when a lender becomes an operator for purposes of CERCLA liability. The lender, Fleet Factors Corp. (Fleet), was advancing funds to Swainsboro Print Works (SPW) against the assignment of SPW's accounts receivable.<sup>72</sup> As additional collateral, Fleet received a security interest in all of SPW's inventory, equipment, and fixtures, as well as SPW's real estate or plant facility.<sup>73</sup> In August 1979, SPW filed Chapter 11 bankruptcy, and Fleet continued to advance funds to SPW as debtor-in-possession pursuant to an agreement approved by the bankruptcy court.<sup>74</sup> Almost a year and a half after the bankruptcy filing, Fleet ceased advancing funds and SPW ceased operations.<sup>75</sup> SPW was later adjudged bankrupt under Chapter 7 of the Bankruptcy Code, and a liquidation of assets was initiated.<sup>76</sup> Fleet foreclosed on some of the inventory and equipment, but not on the real estate.

In May 1982, Fleet entered into a contract with Baldwin Industrial Liquidators (Baldwin) to auction some of SPW's inventory and equipment.<sup>77</sup> In June 1982, Baldwin sold the items "as is" and "in place."<sup>78</sup> All purchasers had the responsibility to remove their purchases. In au-

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ing, such allegations would be sufficient at the motion to dismiss stage to overcome a security interest exemption defense. Also, First Federal probably would have to offer some evidence that it could meet the security interest exemption. Such an evidentiary offering would convert the motion to dismiss into a summary judgment motion. Of course, First Federal still could raise the issue by summary judgment after the decision on the motion to dismiss by the Fifth Circuit. *See id.* at 1571-72.

67. *Id.* at 1572-73 (citing 42 U.S.C. § 9607(a) (Supp. V 1987)). The court relied upon *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573 (D. Md. 1986), to support its ruling. *Tanglewood*, 849 F. Supp. at 1573.

68. *Tanglewood*, 849 F.2d at 1573 (citing 42 U.S.C. § 9607(a)(2) (Supp. V 1987)).

69. *Id.* (citing 42 U.S.C. § 9607(a)(3)-(4) (Supp. V 1987)).

70. *Id.* at 1572-75.

71. 724 F. Supp. 955 (S.D. Ga. 1988).

72. *Id.* at 957.

73. *Id.*

74. Chapter 11 of the Bankruptcy Code allows a debtor to submit a plan to reorganize and restructure debts. *See* 11 U.S.C. §§ 1101-1174 (1988).

75. *Fleet Factors*, 724 F. Supp. at 957-58.

76. *Id.* at 958.

77. *Id.*

78. *Id.*

gust 1982, Fleet contracted with Nix Rigging Company (Nix) to remove the remaining equipment, and "to leave the premises in 'broom clean' condition."<sup>79</sup> Nix left the facility in December 1983.<sup>80</sup>

In 1984, an EPA inspection allegedly found asbestos and approximately seven hundred fifty-five-gallon drums containing toxic chemicals. The EPA spent almost \$400,000 to clean the site. The government sued Fleet Factors and other individual defendants for the cleanup costs relating to the removal of the drums and asbestos allegedly disturbed by Nix or the purchasers.<sup>81</sup>

The case was before the court on motions for summary judgment by both the government and Fleet.<sup>82</sup> The court focused on three time periods in determining whether Fleet was an "operator" under CERCLA: the period before the auction; the period after Baldwin entered the facility to prepare for the auction until the time Nix left; and the period between the time Nix left and a tax foreclosure sale in July 1987.<sup>83</sup>

Although the court denied Fleet's summary judgment motion, it ruled as a matter of law that Fleet was not an owner or operator of the facility after Nix left the facility.<sup>84</sup> The court found that Fleet never foreclosed on the property, had no control over or access to the facility nor engaged in any activities there between the time Nix left the site and the time of the tax lien foreclosure.<sup>85</sup> The court ruled that during the relevant period Fleet had protected its security interest without participating in "day-to-day management."<sup>86</sup>

Without providing further guidance as to the court's factual analysis, the court concluded as a matter of law that Fleet's activities before the auction by Baldwin did not constitute sufficient involvement in

79. *Id.*

80. *Id.*

81. *Id.* at 959.

82. *See id.*

83. *Id.* at 960. The government conceded that Fleet never was an "owner" of the facility under CERCLA. *Id.*

84. *Id.*

85. *Id.*

86. *Id.* The *Fleet Factors* court offered the following statutory construction of 42 U.S.C. § 9607(a)(2):

I interpret the phrases "participating in the management of a . . . facility" and "primarily to protect his security interest," to permit secured creditors to provide financial assistance and general, and even isolated instances of specific, management advice to its debtors without risking CERCLA liability if the secured creditor does not participate in the day-to-day management of the business or facility either before or after the business ceases operation.

*Id.* at 960 (ellipsis and emphasis original) (citing *United States v. Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,994 (E.D. Pa. Sept. 4, 1985).

management for liability to attach under CERCLA.<sup>87</sup>

Finally, the court found Fleet's alleged activities through Baldwin and Nix sufficient to create genuine issues of material fact which could not be resolved by motion for summary judgment.<sup>88</sup> The government alleged that Baldwin moved barrels of toxic chemicals prior to the auction, and that Nix or the equipment purchasers disturbed friable asbestos on pipes connected to the equipment not sold at the auction.<sup>89</sup> The alleged condition of the plant after the departure of Baldwin, Nix and the purchasers created the threat to public health and environment which required the government to incur the ultimate response costs.<sup>90</sup>

The *Fleet* decision presents two clear warnings for lenders. First, lenders may be held liable under CERCLA when the foreclosure of a security interest arguably contributes to or causes an environmental hazard. Second, lenders must take care in contracting with others to handle hazardous substances, or even allowing others access to areas containing hazardous or potentially hazardous materials.

### III. RESOURCE CONSERVATION AND RECOVERY ACT

Congress enacted the Resource Conservation and Recovery Act (RCRA)<sup>91</sup> in 1976 to provide comprehensive, prospective regulation of the generation, treatment, storage, and disposal of hazardous waste. Congress designed the Act to accomplish this goal through a detailed permitting system for treatment, storage, and disposal (TSD) facilities and a manifest system for the transportation of hazardous waste.<sup>92</sup> RCRA, therefore, imposes a "cradle-to-grave" system of regulation for hazardous waste that focuses primarily on existing and future activities. Congress amended RCRA in 1984 by enacting the Hazardous and Solid Waste Amendments.<sup>93</sup> The amendments provided the EPA with expanded permitting authority and increased enforcement authority to deal with violators.

RCRA is not directly applicable to lenders in most situations. Normally, RCRA only affects lenders in the sense that it reduces bottom line profit, which either affects the borrower's ability to replay its loan or reduces the value of the collateral. As RCRA permitting regulations

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87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. 42 U.S.C.A. §§ 6901-6907 (West 1983 & Supp. 1989).

92. 42 U.S.C. § 6925 (1982 & Supp. V 1987).

93. Pub. L. No. 98-616, title I, § 101(a), 98 Stat. 3224 (1984) (codified as amended at 42 U.S.C. § 9601 (Supp. V 1987)).

have expanded, the cost of compliance also has increased.<sup>94</sup> RCRA permits for TSD facilities impose potential cleanup obligations upon the permit holder.<sup>95</sup> The 1984 RCRA amendments require, as a condition of the TSD permit, cleanup of any release from a solid waste management unit (SWMU) regardless of when the release occurred.<sup>96</sup> Cleanup may be required for a release of a regulated substance from an interim status facility.<sup>97</sup> Additionally, the EPA has adopted regulations which prohibit the installation of underground storage tanks that will not prevent the release regulated substances.<sup>98</sup> The regulations also require owners of underground storage tanks to notify state or local agencies of the existence of the tanks.<sup>99</sup> Therefore, a TSD facility may be required to correct problems caused by old disposal practices, including those implemented or caused by a prior owner, as a condition to continuation of its business. Furthermore, RCRA permits require closure provisions, including financial assurance provisions that the permittee will clean up the site once the permit terminates.<sup>100</sup>

TSD facilities under RCRA are subject to other sources of liability. The EPA can impose cleanup orders and penalties, both civil and criminal, for violation of the Act.<sup>101</sup> Both the EPA and citizens can institute legal action to require cleanup of contamination that poses an "imminent and substantial endangerment to the public health or welfare or the environment" caused by past or present handling, treatment, storage, or disposal of a regulated substance.<sup>102</sup>

The courts have given broad interpretation to the substantial endangerment provision of RCRA. In *United States v. Price*<sup>103</sup> the court concluded that although RCRA does not provide the government with general cleanup authority for dormant waste sites, it does provide substantial authority to limit further harm to the environment.<sup>104</sup> For ex-

94. See generally 40 C.F.R. §§ 260-265 (1989) (hazardous waste management requirements).

95. See *United States v. Waste Indus.*, 734 F.2d 159 (4th Cir. 1984); *United States v. Ottati & Goss, Inc.*, 630 F. Supp. 1361 (D.N.H. 1985). Both *Waste Industries* and *Ottati* recognize the EPA's authority to maintain an action to require waste storage groups to abate the threat of public health and environment caused by leaking hazardous waste.

96. 42 U.S.C. § 6924(u), (v) (Supp. V 1987).

97. 42 U.S.C. § 6928(h) (1982 & Supp. V 1987).

98. 40 C.F.R. § 280 (1989).

99. *Id.* § 280.50.

100. *Id.* §§ 112, 264.143.

101. 42 U.S.C. § 6928(d), (g) (1982 & Supp. V 1987).

102. *Id.* § 9606(a); see also *id.* §§ 6928(a)(1), 6972 (provisions allowing civil suits by citizens and the EPA).

103. 523 F. Supp. 1055 (D.N.J. 1981), *aff'd*, 688 F.2d 204 (3d Cir. 1982).

104. *Id.* at 1070-71.

ample, under RCRA the government may restrain the continued leaking of contaminants from a landfill into the environment.<sup>105</sup> The court reached this conclusion, in part, because of the broad definition of disposal, which includes the leaking of hazardous substances from the landfill into the groundwater.<sup>106</sup> Potential liability was imposed upon the property owners even though all disposal had ceased before their purchase of the property. Although the purchasers had knowledge of the landfill prior to purchase, the court indicated that a purchaser without knowledge may be liable because a sophisticated investor has a duty to investigate the actual condition of the property or take the property as it is.<sup>107</sup> The court further concluded that purchasers without knowledge may be liable because the legislative history indicates a congressional intention to construe the disposal definition broadly.<sup>108</sup> It should be noted that RCRA does not contain an "innocent landowner" defense as does CERCLA.<sup>109</sup> Therefore, a lender which takes title to property to protect its security interest may be subject to cleanup liability under RCRA even though such liability could not be imposed under CERCLA.

Banks also encounter potential RCRA liability when they hold title to property as trustee. A bank-trustee, as an owner of a facility, is responsible for fines and penalties when a tenant fails to comply with RCRA.<sup>110</sup> A significant source of such liability for bank-trustees is the underground storage tank (UST) provisions of RCRA added by the 1984 amendment.<sup>111</sup> The UST regulations promulgated by the EPA require notification of the size, age, location and contents of USTs.<sup>112</sup> These same regulations provide for modification and retrofit of existing systems over the next ten years,<sup>113</sup> and provide cleanup requirements for any UST that leaks a regulated substance to the environment.<sup>114</sup> Banks should ensure that their borrowers and trust departments comply with the UST regulations, since failure to comply will result in significant statutory penalties.<sup>115</sup>

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105. *Id.* at 1071.

106. *Id.*

107. *Id.* at 1073.

108. *Id.* (citing S. REP. NO. 172, 96th Cong., 2d Sess. 5, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 5019, 5023).

109. For the text of CERCLA's "innocent landowner" defense provisions, see 42 U.S.C.A. § 9601(35)(A)(i) (West 1983 & Supp. 1989).

110. See 42 U.S.C. § 6924 (Supp. V 1987); 40 C.F.R. § 260.10 (1989).

111. See 42 U.S.C. § 6991 (Supp. V 1987).

112. 40 C.F.R. § 280.22 (1989).

113. *Id.* § 280.21.

114. *Id.* §§ 280.60-.67.

115. See, e.g., 42 U.S.C. §§ 6928(d), (g), 6991d(b)(2), 6991e(d) (1982 & Supp. V 1987).

RCRA encourages the individual states to formulate and enforce their own hazardous waste management plans consistent with the Act.<sup>116</sup> In South Carolina, DHEC has this authority and, within the parameters of the state plan, may promulgate and enforce regulations for handling of hazardous waste.<sup>117</sup> Notwithstanding this delegation of authority, the EPA retains its ability to enforce the federally based program and all the rights attendant to that power.<sup>118</sup>

As with RCRA, the South Carolina Hazardous Waste Management Act is predominantly a regulatory statute and normally will not affect lenders directly unless they actively participate in management and operation of a facility that falls within the scope of the regulations.<sup>119</sup> Borrowers, however, may be subject both to DHEC and EPA regulations. Fines, penalties and injunctions may impair a borrower's ability to continue business or meet obligations it has to lenders. A clear example of how much liability a borrower can incur as a result of EPA and DHEC regulations is found in *United States v. T & S Brass and Bronze Works, Inc.*<sup>120</sup> The defendant, a South Carolina manufacturer who violated several permitting requirements of RCRA, was fined \$1,000 per day (for a total of \$194,000) by the EPA (the potential fine was \$25,000 per day) and also was fined \$19,500 by DHEC. In addition, the defendant was compelled to clean up its existing in-ground hazardous waste disposal site and was forced to refit its facility with above ground storage tanks. Thus, the enormous expense which violations of RCRA or DHEC regulations may bring should be a source of concern for every lender. Lenders should protect their interests by closely evaluating the past and present practices of potential borrowers for possible violations of any environmental laws.

#### IV. CONCLUSION

The potential liability under the federal and South Carolina superfund and hazardous waste laws is so great that lenders must take steps to protect themselves against the various legal and business risks that arise. The statutes and relevant cases discussed this Article

116. See *id.* § 6947 (1982).

117. See S.C. CODE ANN. §§ 44-56-10 to -840 (Law. Co-op. 1976 & Supp. 1989).

118. See 42 U.S.C. §§ 6927(a), 6928, 6973 (1982 & Supp. V 1987).

119. DHEC has promulgated Hazardous Waste Management Regulations under authority of the South Carolina Hazardous Waste Management Act. See S.C. CODE REGS. 61-79.124, -79.260 to -79.266, -79.268, -79.270 (1989). DHEC does not yet have full RCRA permitting authority and the EPA has not approved a state plan for the additional permitting requirements imposed by the Hazardous and Solid Waste Amendments of 1984.

120. 681 F. Supp. 314 (D.S.C. 1988), *modified*, 865 F.2d 1261 (4th Cir. 1989) (upholding fine and injunction with technical modification).



demonstrate that lenders must closely scrutinize borrowers with environmental compliance problems, cautiously avoid excessive participation in the business affairs of the borrower, carefully evaluate the environmental condition of real estate as security for a loan, and prudently consider potential environmental problems in the foreclosure decision.

In order to minimize exposure to environmental liability, lenders should develop an environmental risk and liability policy. The Office of Regulatory Activities of the Federal Home Loan Bank System has issued a bulletin that contains a guideline for establishing an environmental risk policy.<sup>121</sup> The bulletin identifies the following components as essential for a lender's environmental risk policy:

1. A stated assessment of potential environmental problems and liabilities . . . and a declaration that a policy of due diligence is adopted to protect the institution from such risks.
2. A requirement that loan applicants provide information on environmental matters pertaining to their business and facilities. Institutions should develop a form covering specific questions to which applicants respond. The questions should request information concerning past, present or proposed uses of the proposed collateral, potential hazards, insurance availability for the property as it pertains to environmental matters, and contracts by any Federal, state, or local government agencies concerning environmental matters that must be resolved in order to obtain business and environmental permits.
3. A requirement that an acquiring institution, in a purchase or participation loan, ensure that adequate due diligence regarding environmental risk matters has been met by the lead lender and a requirement that all loans sold to Freddie Mac or Fannie Mae meet with the environmental due diligence standards imposed by those agencies.
4. A requirement that all loan requests, in which the proposed real property collateral has a higher environmental risk potential than other types of real property, have a Phase I Environmental Risk Report . . . prepared for the institution prior to approval of the loan.<sup>122</sup>

In addition to the components identified by the Thrift Bulletin, lenders also should consider including protective provisions in loan documents,<sup>123</sup> requiring adequate insurance coverage, and minimizing their involvement in business affairs of borrowers. An environmental risk policy is no guarantee that a lender will not face environmental liability, but it will minimize any potential liability and reduce the chance that the institution will make high-risk loans.

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121. See FEDERAL HOME LOAN BANK SYSTEM, OFFICE OF REGULATORY ACTIVITIES, THRIFT BULLETIN TB 16 (February 6, 1989).

122. *Id.* at 2.

123. These provisions might include covenants, representations and warranties, and indemnification clauses.